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## The „halal” criterion in the reformist conception of conventional finances

### Introduction

The management of public affairs and the performance of each government are assessed and appreciated according to the efficiency and effectiveness of the objectives decided in political choices. The criteria of such an evaluation are based on various fields, but a more significant value is attributed to regulations satisfying the collective needs, especially regarding financial policy, efficiency of public services and a fair redistribution of wealth. The State, when fulfilling this task, symbolizes the collective identity of a group, defining the social model and its values. In consequence, the governance is legitimized and confirmed by citizens in the electoral campaign for a new term. For this reason the State, in the continuity of its functions, has to be more creative and flexible and that is why politicians appeal to reforms which redefine the orientations precedence and means to realize it. Traditionally, reforms with a concrete impact are those affecting economic and financial regulations. However, before addressing this point, in the second part of this paper, it would be interesting to expose the concept of reforms, its instruments and objectives.

Semantic debates on reforms, as actions directed to improve the functioning of the public administration, represent an old aspiration that man experienced well before the Greek era.<sup>1</sup> It means provisions and disposi-

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<sup>1</sup> Among the expressive reforms transmitted by historians, specialists refer to Hammurabi's code (around 1750 BC), with all the changes that this codification brought to the Mesopotamian civilization. Then they refer to the Clisthenian reforms in ancient Greece in 508 BC.

tions to improve the effectiveness and profitability of public institutions and actions by emanating new regulations. In the new public management, it is to reduce expenses in the public budget, possibly by measures increasing productivity, improving public services, reducing taxes, or limiting the State interference in the economy. These manoeuvres characterising the State's evolution are taken to adapt to the constraints of politics and to the new management.<sup>2</sup>

### **Reform is more than just changing administration**

State reforms and social conflicts are closely interrelated; while a State reform can be seen as a prerequisite for the evolution and wealth, it can also easily become the source of a social conflict. The potential of the State reforming itself depends on the proper structures, values and rules allowing the society to grow. A State reform must include more than just a reorganisation of the administration or that of the way in which resources are allocated. Rather, it has to set a legitimised compact processes forging a democratic system. To reach such a goal, the reform must be based on sustainable values, such as pluralism, tolerance, inclusiveness and the supremacy of the rule of law. It has to introduce a behavioural model in which citizens enjoy fairness and dignity. Nevertheless, a reform can also be poorly understood and consequently rejected by the masses, generating a social conflict. In situations of an externally induced rapid change, a reform easily becomes the source of violent reactions from the population undergoing oppression from the ruling regime. A State reform must therefore be built as a fair process seeking acceptance even if in the form of a compromise between different parts of the society. Politicians must demonstrate a great deal of knowledge in order to avoid social conflicts, not only by the mitigation of crises, but by the realization of reforms in the context of social cohesion. Therefore to prevent an excess of reforms introduced and their harmful effects, it is necessary to assume a more comprehensive approach and to have good governance at one's disposal.

In the global system, the golden rule that emerges from experienced reform processes in different countries shows that reforms have typically been evaluated considering the financial and monetary policies imposed by the governance. In different countries in the world, the role of the government is primarily to satisfy the conditions of the international instances of finance, like the IMF and the international bank. They rarely dispose of a limited margin for manoeuvre to conciliate constraints and needs of populations in their politics. Speaking about reforms, globalization on its part,

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<sup>2</sup> G. Bächler, *Conflict Transformation through State Reform*, Berghof Research Center for Constructive Conflict Management – Edited version Aug 2004, p. 2-3.

given the intensity of its new provisions, imposed a challenge matching the desired status from leaders and the raw reality on the limited potential of countries' resources. Such a status-quo allowed the emergence of alarming voices requiring a review of the concept of reforms, its instruments and goals. Rethinking reforms as experimented today leads to a doubtful confirmation of the sovereignty of states, the principle of non-interference and the compulsory abiding by international law.<sup>3</sup>

Considering the State as a sovereign nation, basing its legitimacy on the supremacy of the rule of law and on the fair redistribution of wealth, makes interests of specialists be directed towards changing the institutionalized dynamics. In this process, the reform comes in accordance with the modality and issues as planned in the government's tasks. The success of reforms satisfying the population's needs and governors' intentions becomes a model to follow for other governments. Obviously, only the nation is legitimized to recognize this success, taking into account the role of the State creating a collective sense of belonging by redistributing resources to the population (wages, public services, social assistance, etc.).<sup>4</sup>

Generally, reforming the State refers to executing changes affecting the structure and functions of different entities. Such changes have systematized dynamics, allowing these entities to adapt to the new circumstances according to diversified and different cultural environments, ethics and values. Officially this new aspect of management is reflected on an announced neutrality of political orientation and moral dimension binding all parties in the space and time. As a reform is the matter of geopolitical strategy, the success and the impact of its realization differ from developing to developed countries.<sup>5</sup>

## Financial reform

A financial reform can be identified as a change affecting the financial sector in its constituents (banks, other institutions, instruments and markets), or in its process when mobilising and allocating resources (from the surplus sector to the needy ones). The goal of such a reform is to provide the financial system with more effectiveness. Innovation and reform in fi-

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<sup>3</sup> M.A. Ben Jillali, *Building the state: concept, theory and current questions*, Egyptian Institute for Political and Strategic Studies, Istanbul 2016, p. 2-5.

<sup>4</sup> C. Dejima, K. Gatelier, I. Samson, N. Zagainova, *Processus de transition et réforme de l'Etat La reconstruction de l'Etat dans le post-conflit: quel Etat post-national?*, Grille d'analyse de la construction de l'Etat élaborée en collaboration avec le CREPPEM, Université Pierre Mendès France, Grenoble 2005, p. 2-4.

<sup>5</sup> M.A. Ben Jillali, *Building the state: concept, theory and current questions*, Egyptian Institute for Political and Strategic Studies, Istanbul 2016, p. 2-5.

nance can be beneficial to growth, but its costs, in some situations, could be misunderstood and not blessed by the majority of population and actors taking part in this transformation. Usually politicians and experts find it very difficult to persuade their opponents and audience to accept their choice, especially explaining how economic performance could be harmed by restrictions on financial activity. However, the least convincing is that the public financial authorities have to drop the controlling and regulating role to appear helpless against the expansion of the liberalisation and deregulation. Evidence is that financial reform dynamics have a heavy and lasting impact on people's consciousness and memory. It has never been either appreciated or positively evaluated. Traditionally, a fluctuating financial reform focuses on factors, such as interest rate liberalization, credit allocation controls and high reserve requirement, capital accounts liberalization. In the last rank there come measures to improve the strength of banking prudential regulation and supervision.<sup>6</sup> From the consumer's point of view, the experienced financial reform always leans in favour of financial institutions and banks. A simple overview on the history of financial reforms shows that reforms and outcomes undertaken remain a variable detached from the progressive impoverishment of the majority of nations, especially of the middle class. To mitigate the rising rage of populations, from time to time, the voices of some politicians or experts rise to denounce the lack of fairness in redistributing wealth, unemployment crisis and increasing poverty. The impact of its disadvantages is well represented in the official discourses of international bodies.

For a long time half of the global wealth has been monopolized by 1% of the world population. In its 2012 report, the European Commission highlighted the severity of inequality and warned of its negative effects on the well-being of families and society in general. In the 2014 OECD report, it was stressed that unequal income distribution slows the economic growth and that disparity in the distribution of household incomes has been increasing during the last decades among the members of the organisation.<sup>7</sup> The United Nations' efforts in 2000 in cooperation with several global financial institutions (World Bank, IMF and Islamic Development Bank (IDB)), resulted in a common policy known as Millennium Development Goals (MDGs), to fight disparity and reduce extreme poverty. For the same goal another program was initiated known as the Sustainable Development Goals (SDGs), precisely timing to reduce the masses of people living on less than \$1.25 a day to 3% globally by 2030.

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<sup>6</sup> S.F. Iftikhar, *Financial Reforms and Financial Fragility: A Panel Data Analysis*, „International Journal of Financial Studies” 2015, p. 87-88.

<sup>7</sup> F. Cingano, *Trends in Income Inequality and its Impact on Economic Growth*, „OECD Social, Employment and Migration Working Papers”, No. 163, OECD Publishing. 2014, p. 7-9.

Considering this *status quo* that derives from the global new order, conventional financial industry permitted another new variation which is part of its strategy to maintain wealth dominated by money as its source, wherever is it. Concretely, in the recent decades, there has been noted a relative integration and expansion of Islamic finance, even if regarding, in the majority of cases, the sovereign forms, such as “joint venture” or other transactions between institutionalized structures that have a minimum impact on household’s well-being. *Halal* Finance no longer seems to be bothering the financial market actors as long as it keeps away from simple consumers and households, which appears reserved for conventional finance in Europe. It is also likely that these new financiers are not interested in this category of customer, and this would be a complete negation of its principles as fair finances.

### **“Halal Finance” as a global reform for shared prosperity**

The term “shared prosperity” refers to a connotation related to equity in wealth distribution, the idea focuses on the well-being of less fortunate people, as an instrument measuring society’s growth. As a criterion used by the World Bank, “shared prosperity” uses income growth per capita in the lowest 40 per cent of the population in each developing country as an indicator of growth. “Shared prosperity” imposes economic growth because it is quasi-impossible to increase the incomes of the poor without the overall growth of the economy. “Sharing prosperity” means continuing improvement in the well-being of the poor, in a sustainable manner across generations. This requires strong investments and job creation in an environment supported by the State, private and in some situation by non-governmental organizations. This demands basically a stable social system with a healthy economic and political vision guaranteeing the sense of security that stimulates growth generating resources to invest in improving opportunities for all; it requires also a necessary protection of the vulnerable against deprivation and exclusion. In effect, lately the global financial system has shown its interest in the potential and the effectiveness of Sharia finance when offering services through nonbank financial institutions (housing finance or leasing). The non-greedy Islamic finance supporting a fair distribution of wealth and a real economy presents a significant possibility to fight and defeat the exclusion of the poor population by replacing speculation and exploitation by a globally shared prosperity. Such a noble goal can be achieved through institutions, such as *Qard-Hassan* (benevolent lending), *Waqf* (Islamic endowments), and *Sadaqa* (charity) that provide resources for public education, health care and employment.<sup>8</sup>

<sup>8</sup> World bank group, *Islamic finance: a catalyst for shared prosperity*, p. 17-35, Washington 2016.

The Public-Private Infrastructure Advisory Facility report of January 18, 2018, announced the start-up of the Islamic Development Bank Group (ISDBG) and the World Bank Group partnership, inciting “Halal Finance” to invest in infrastructure, public-private partnerships showing the realized project which focuses on difficulties faced and suggested proposals to enlarge the exploitation of Islamic finance to this end.<sup>9</sup>

### **The *Halal* equivalent of prosperity and inclusion**

In the Islamic legal system, the word “halal” (in Arabic: «لالح») means lawful and permissible. In a broad sense, it is about a divine path of life (food, drinks, and clothing, etc.) and includes also behaviour and morals or things (tangible or intangible) subjected to our disposal (ownership, sale, etc.) permitted by Sharia. The basic rules of halal finance is that money itself could never be a source of enrichment, it has an acquired value only when it serves as an instrument of exchange. The interest due to time (usury) factor does not exist in Sharia-finance, it is an asset-based system rather than debt-driven.<sup>10</sup> It imposes profit and risk sharing through a ratio-participation in business.

“Halal finance” is divided into two categories: participatory and non-participatory instruments, in the first case ones being provided through equity participation, profit and loss sharing in return for equity or rights to share in a predetermined percentage of profits. In the other case, they are provided through commitment to deliver or manufacture commodities, the sale and lease of assets for engagement to repay their value or for their usufruct at a later date.<sup>11</sup> The inclusion in the Islamic finance model is carried out mainly in two ways: in the first place, it is risk-sharing to stabilize transactions between the parties and, secondly, it is fair distribution of the wealth to stimulate consumption and growth, guaranteeing homes and individuals a decent life.<sup>12</sup>

### **The official proclamation of the reform**

Since its integration into the global financial industry, “halal finance” proposed itself as a reform of the conventional system fighting against usury, speculative abuse, against the lack of rules protecting individuals,

<sup>9</sup> UK Excellence in Islamic Finance, London 2018.

<sup>10</sup> Zero nominal interest rate is a necessary condition for the optimal allocation of resources. The use of general equilibrium models shows that a zero interest rate is both necessary and sufficient for allocative efficiency.

<sup>11</sup> A.L.M. Abdul Gafoor, “Islamic Banking and Finance”, Toronto, CA-1999, p. 7-17.

<sup>12</sup> Z. Iqbal, A. Mirakhor, “Financial Inclusion: Islamic Finance Perspective”, Journal of Islamic Business and Management, Vol. 2 No. 1, Pakistan 2012.

against the hegemony of banks and other financial institutions. The World Bank Group<sup>13</sup> and the Islamic Development Bank,<sup>14</sup> in the first global report on Islamic Finance for 2017, officially reformed the concept of global finance recognizing and attributing to Islamic finance the role of the catalyst realizing sustainable development goals reducing income inequality and sharing prosperity.<sup>15</sup> This reform, which has remained work in progress today, requires a considerable effort to appear as an industry that does not threaten conventional finance. This condition raises a great deal of doubt, an attitude which seeks to answer the questions: *Which of the two systems must change its principles? Is this Islamic finance that will be bent to speculation and usury or is it conventional finance that will regain its purity?*

No matter how and when this question will be answered, achieving the integration of “halal finance” in the global market requires the regulatory and the supervisory to face systemic risk, fixing innovative risk-sharing instead of reproducing conventional risk-transfer, enhancing Islamic finance, and fighting literacy. In its more expressive reformist thinking, the report raises the awareness of decision-makers to develop the social aspect of Islamic finance and non-banking financial instruments such as, Islamic insurance (*takāful*),<sup>16</sup> *qard hasan*,<sup>17</sup> *zakat*,<sup>18</sup> *sadaqāt*,<sup>19</sup> and *waqf*,<sup>20</sup>

<sup>13</sup> The World Bank Group (WBG): is the largest development bank in the world, and is an observer at the United Nations Development Group, with the mission to fight extreme poverty and build shared prosperity. The bank provides loans and assistance to „developing” and transition countries. It is formed by five organizations: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes (ICSID).

<sup>14</sup> The Islamic Development Bank (IDB): is a multilateral development financing institution located in Jeddah, Saudi Arabia. It was founded in 1973 by the Finance Ministers at the first Organisation of the Islamic Conference. IDB Group is engaged in a wide range of specialized and integrated activities such as: project financing in the public and private sectors; development assistance for poverty alleviation; technical assistance for capacity-building; economic and trade cooperation among member countries; SME financing.

<sup>15</sup> The World Bank Group global report of 2016 on the Islamic finance, “Islamic Finance a Catalyst for Shared Prosperity?”

<sup>16</sup> *Takāful*: is a mutual aid in which subscribers pay a certain amount, which is deposited into a pool of liquidity with other subscribers’ contributions to compensate the insured losses.

<sup>17</sup> *Qard Hasan*: an interest-free loan, a situation whereby the borrower has to pay only the amount of the loan. Integrating Islamic finance into the global finance: IMF – World Bank G 20 note. Turkey Antalya summit 2015.

<sup>18</sup> *Zakāt*: a tax, comprising percentages of personal income of every kind, levied as almsgiving for the relief of the poor: the third of the Pillars of Islam.

<sup>19</sup> *Sadaqāt*: a word commonly used in the Qur’ān for charity, other time it came as compulsory levies, taxes in modern parlance, to establish an unequivocal connection between these levies and the redistribution of income.

<sup>20</sup> *Waqf*: or *habous*, is an inalienable charitable endowment which involves donating a building, plot of land or other assets with no intention of reclaiming it.

which benefit households and entrepreneurship improving their access to financial services.

To further materialize this reform at the global institutional level, we make use of the note presented by the World Bank and the IMF at the G20 in Antalya, Turkey, which states the following, considering the global standards:

- The regulations in the countries concerned by Islamic finance have to encourage Islamic financial institutions and services by adapting regulatory and supervisory frameworks to ensure the effectiveness of this system, especially managing liquidity of Islamic Banks.
- The introduction of a taxation system ought to be compatible with the aims and instruments of Islamic finance;
- Access needs to be facilitated to asset-based and equity-based financing, in particular for SMEs;
- The use of *Sukuk* markets (bonds) is meant to finance investments through pooling assets for regular issuance of tradable instruments while strengthening public investment frameworks.<sup>21</sup>

## Conclusion

The impact of this financial reform still depends on more profound changes related to governance, to political culture and, above all, to behavioural model officially promoted. The inclusion of different specificities and respect for them must be the base of proper relations in each society for shared future and prosperity. The extreme liberalization of the financial market and the destabilizing practices remain the enemies to fight if one wants to think of a financial system for all, without exclusion or exploitation. Never deregulation can be synonymous with a reform; nor can one find a cure for dysfunctions of the financial system. A financial reform must first and foremost propose something new and functional to fight against misfortunes of the excluded and limit the monopoly of finance services by the easiest. We need more convincing and courageous decision-makers to convert the financiers to a faith other than mammonism, we need a belief that allows everyone to live without having to give up the dignity and sometimes the life.

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<sup>21</sup> Integrating Islamic finance into the global finance: IMF – World Bank G 20 note. Turkey Antalya summit 2015.



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#### THE “HALAL” CRITERION IN THE REFORMIST CONCEPTION OF CONVENTIONAL FINANCES

**Abstract:** In this paper, the author presents “*halal finance*” as a reform of the conventional financial system. Starting with a presentation of the vision of the meaning of the reform, which differs from that perceived by old civilizations, he tries to cast light on the role of the reform and its impact on the development of society in general. At the second stage, attention is paid to the connotation of the new management of public affairs and financial reforms. In the last part, the author demonstrates how conventional finances integrate *halal finance* as a reform considering the changes that have marked the financial industry in recent years, especially the explosion of petrodollars, the deregulation and liberalization of financial markets.

**Keywords:** HALAL, FINANCE, MARKET, REGULATIONS, INCLUSION, TRANSACTION, BANK, MAMMONISM